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Neogenius: b2b or (not) to be?

Professors Dominic Lim and Eric Morse wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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John Kim, chief executive officer of NeoGenius Co., Ltd. (NeoGenius), was deep in thought as he left the office late one Friday afternoon in June 2001. He and his cofounders had just concluded a long meeting, during which they had debated the future of their company. The information technology (IT) start-up provided a wide range of business-to-business (B2B) e-business software and related services in South Korea. During the past few months, Kim had received significant offers from three different entities: a business partner, a competitor, and a venture capitalist. He had until the end of June—only a week away—to make a decision that would have a dramatic impact on NeoGenius and its cofounders.

NEOGENIUS CO., LTD.

Kim, a former IBM e-business specialist, started NeoGenius in Seoul in February 2000. Kim was one of six cofounders; his partners were two former IBM employees and three young programmers with whom Kim had worked on various consulting projects during his own career at IBM. Kim thought the team had an ideal combination of skills and experiences, both for investors and for potential clients. He had spent more than 10 years in management and IT consulting with KPMG and IBM. His two IBM colleagues also had over 10 years of experience each in IT project management and systems sales with IBM and several small Internet ventures. Together, the three former IBM staff members had substantial experience dealing with blue-chip clients such as Samsung Electronics and Hyundai Motors.

The remaining three cofounders were young and energetic; they were younger than Kim, but they all had outstanding educational and professional backgrounds, having graduated from South Korea’s top computer engineering program at Seoul National University. Each had three to four years of experience working on several large-scale e-business systems-development projects with IBM and PwC Management Consulting.

The founding partners had raised KRW100 million (US$100,000)[[1]](#footnote-1) in seed funding, mainly through their retirement benefits. By August 2000, NeoGenius had secured KRW550 million in funding from business angels and several institutional investors, most of whom were acquaintances of the cofounders. The founding partners collectively held 80 per cent of the shares and had delegated some of their voting rights to Kim, giving him a total of 35 per cent of voting rights.

After founding NeoGenius, the team spent the first several months looking for a business idea, while developing and patenting various software programs, such as a search engine and a web-based e-mail system. However, it became obvious over time that the team’s core competence was in e-business.

THE BUSINESS-TO-BUSINESS (B2B) E-BUSINESS MARKET

In 2000, Deloitte Consulting forecast that the global B2B-related e-business market would grow from US$180 billion in 1999, to more than US$1,234 billion in 2001, powered by increasing volumes of B2B transactions. Although estimates varied, nearly all industry reports predicted exponential growth in the B2B e-business market.

The B2B sector consisted of two types of firms: (1) those engaged in an electronic marketplace, buying and selling products and services online, and (2) technology providers selling the software necessary to build and maintain B2B infrastructures and marketplaces. Advanced Market Research estimated that B2B software accounted for about 5 per cent of the total B2B e-business market in 2000. International Data Corporation predicted that the B2B e-business application market would reach US$9.7 billion by 2004, or 9.7 per cent of the total B2B market.

Lehman Brothers identified three key drivers of B2B e-business. First, competitive dynamics in the value chain would incentivize market participants—buyers, sellers, and market-makers—since B2B e-business had the potential to redistribute power within the value chain. Second, each participant had well-defined objectives (e.g., efficiencies or reduced fulfilment cycles). Third, B2B e-business was driven by network effects. The Organization for Economic Cooperation and Development estimated that the benefits B2B could generate across the world’s five most industrialized nations in the 2003–2005 period would include a 50–67 per cent increase in productivity, US$250 billion in inventory savings, a 10–50 per cent decrease in customer service costs, and a 50 per cent decrease in order-processing costs.

It was expected that South Korea would follow the global trend. Samsung Securities forecast that the South Korean B2B e-business market would reach KRW122 billion in 2000 (i.e., 9.2 times its size in 1999). The key drivers were the rapidly growing number of Internet users and various South Korean government initiatives. For instance, the Ministry of Commerce, Industry, and Energy supported the e-marketplace and pressed for industry-wide standards for B2B transactions. Some argued that B2B e-business would help improve the South Korean economy’s efficiency and transparency—areas that had historically been sources of weakness.

These conditions led to a spree of B2B e-business start-ups. Many existing Internet firms also rushed into the B2B arena, building on their traditional business-to-consumer (B2C) customer base. Early 2001 brought a flurry of announcements, as companies sought to position their technological platforms and electronic exchange solutions. Large, established firms in several industries created B2B consortia (e.g., GM-Ford-DaimlerChrysler (Covisint), ForestExpress, and Aero Exchange International). By April 2000, there were more than 60 domestic electronic marketplaces in South Korea. Most were led by conglomerates (also known as chaebols) supported by the Ministry of Commerce, Industry, and Energy.

However, the story did not unfold as smoothly as expected. The B2B e-business market was severely hit by the global economic downturn triggered by the dot-com crisis in mid-2000. IT investment was depressed, particularly in South Korea.

NEOGENIUS: BUSINESS PORTFOLIO

It was not until late July 2000 that the founding team of NeoGenius decided to focus on opportunities in the fast-growing B2B e-business market. In spite of the depressed state of the market, the team members thought the timing was right; they believed that their credentials would appeal to investors that had become more rationalized after the dot-com crisis. After several months of extensive market research, they agreed with the majority of industry analysts, who believed that the B2B area would still take off, despite the global economic downturn. One industry analyst predicted, “If there is any future, it is in the B2B.”

NeoGenius decided to develop its own B2B e-business software package: NeoSite for B2B. It would be launched in late 2000, with features similar to those offered by Ariba Operating Resource Management System (ORMS)—a significantly pricier alternative from a U.S.-based competitor. NeoSite for B2B comprised advanced rule-based Java component modules: e-Catalog, e-Engagement, and e-Fulfillment. The software supported the client-procurement process from beginning to end, with components to support catalogue sourcing, demand forecasting, purchase planning, order requesting, approval, and payment. NeoSite for B2B also offered buyers strategic sourcing features for analyzing demand and supply, selecting suppliers, and managing contracts. The software helped B2B sellers streamline their sales processes, from monitoring catalogues and inventory to managing contacts and billing. Sellers could use the software to track statistical information, generate additional revenue via new sales channels, and reduce the cost of sales operations.

NeoSite for B2B would be NeoGenius’s core business, complemented by B2B e-business consulting, solution development and sales, and implementation services. The team developed a business model and defined 18 potential sources of revenue based on this business plan. They expected that most revenues would be generated through NeoSite for B2B via (1) software package licence fees (direct sales and sales through distributors), (2) maintenance fees (10–15 per cent of licence fees), (3) systems consulting and design fees, and (4) systems implementation service fees. NeoGenius’s initial target markets were industries with relatively high B2B investment trends, low entry barriers, and business processes conducive to NeoSite for B2B. The company initially focused on maintenance, repair, and operation procurement projects in the textile and fashion industry via an alliance with one of its investors, Fanco (see Exhibit 1).

NeoGenius’s priority was to establish itself as a credible player in this new market. During the first year, the company would focus on establishing the software package line-up, recruiting 20 employees, and developing sales channels and alliances. NeoGenius’s first-year sales target was KRW1 billion. In addition to direct sales, the firm planned to exploit market opportunities through partnerships with management consultants and systems integrators. These partners would help market NeoGenius’s software package to their clients and provide feedback on software design and upgrades. One such partner would be i-MRO, a B2B e-business consultancy founded by former A.T. Kearney consultants. Enhancing its value as a possible partner was i-MRO’s extensive network with major chaebols.

COMPETITION

In early 2000, many e-business companies flocked into the B2B space. NeoGenius considered two of these to be direct competitors: eGEN and IB-Net. eGEN claimed to be a total e-business company, providing services such as consulting, solution sales, and business generation support. As of June 2001, eGEN had 72 employees and KRW3.3 billion in capital, making it one of South Korea’s fastest-growing B2B firms. The company had partnered with major B2B consortia, such as AsiaB2BVentures and B2B Korea. IB-Net was a leading B2C e-commerce company in the market. It had two key B2B offerings: Commerce21 Marketplace and Commerce21 Procurement, both based on its Commerce21 B2C suites. IB-Net had experience in developing and operating major B2C e-commerce sites, such as LG Mart, Dacom Interpia, and GoldBank. Its B2B business was built on partnerships with Samsung Corporation and Adexa (SCM). Listed on the KOSDAQ,[[2]](#footnote-2) IB-Net had ample funds and an established client base.

Fourteen active players, including eGEN, organized an industry association called Association for E-marketplace and announced plans for an e-marketplace consortium and an industry standards forum. However, most of these firms were originally B2C e-commerce solution providers like IB-Net, and it was widely believed that they did not possess the expertise to develop marketable B2B solutions. In early 2000, no one player dominated the South Korean B2B market.

NeoGenius could not avoid competing head-to-head with global B2B firms. High-end vendors such as Ariba and CommerceOne were active in the South Korean market, and they were targeting large-scale B2B projects with proven technologies and solutions. Ariba was the top B2B solution vendor in the world. It was well known for its ORMS and its B2B portal, Ariba Network. Ariba maintained a high-price strategy, targeting large enterprises with revenues greater than US$1 billion. It did not have in-house systems-integration capabilities; instead, it focused on package sales through partnerships with major systems integrators and consulting firms. Ariba had established a Seoul office to explore the South Korean market, but had had little success. The major barrier was likely its licence fee, which was as high as US$5 million (KRW6 billion). Many South Korean companies saw ORMS’s lack of localization, in terms of South Korean business processes and language, to be one of its key weaknesses.

Major back-end solution vendors such as Oracle and SAP were also aggressively exploring market opportunities with new B2B offerings. They had a strategic advantage because their B2B solutions were tightly linked to their existing database and enterprise resource planning (ERP) packages, so they could leverage their established client bases. Oracle was particularly aggressive in penetrating the South Korean B2B market with a solution package based on components of Oracle ERP and e-commerce suites. However, it would be some time before Oracle could launch a localized solution for the South Korean market.

The NeoGenius team believed that NeoSite for B2B had several advantages over the solutions offered by their global and local competitors. First, NeoSite for B2B was locally developed, and reflected the real-world procurement process in South Korea. Second, NeoSite for B2B would be installed by local technicians, reducing costs and improving support services. Finally, NeoGenius believed that its software—dedicated to B2B, not adapted from other solutions—offered superior technology.

BUSINESS DEVELOPMENT AND PROGRESS TO JUNE 2001

NeoGenius deployed a flat and flexible organizational structure to maximize operational efficiency and personal motivation. Instead of using formal, functional titles, the founding partners called each other by their first names—a significant departure from South Korean tradition. The cofounders hoped that a less formal environment would encourage employees to develop a sense of ownership and responsibility for the success of the company.

NeoGenius grew moderately over the next six months. The company developed partnerships with various major IT solution vendors, including IBM and Sun Microsystems. It recruited additional staff: five programmers, one web designer, and one administrative assistant. By the end of 2000, NeoGenius had acquired one of its partners: Neo Solution, another small IT start-up. NeoGenius then established NeoMobile Co., Ltd., a wholly owned subsidiary built around former key members of Neo Solution. This acquisition provided NeoGenius with four additional highly skilled programmers and several marketable solution suites, such as a questionnaire management system*.* The acquisition alsomeant that NeoGenius could do business with IBM Korea under the NeoMobile banner. (NeoGenius had previously been excluded from IBM projects because of IBM’s policy not to subcontract to its former employees.)

In November 2000, NeoGenius launched NeoSite for B2B. The launch ceremony was hosted by IBM Korea, and an i-MRO senior manager gave a keynote speech. NeoGenius planned to sell NeoSite for B2B through systems-integration projects that customized the software to the client’s business process requirements. This approach seemed particularly appropriate since the software development was far from complete. The development team leader estimated that the software package was about 20 per cent completed; only the basic system architecture and design were in place. These customization projects would provide NeoGenius with test beds for integrating customer requirements into the package. It was around this time that the company received research and development funds from the Ministry of Information and Communication.

In January 2001, NeoGenius established a strategic alliance with Samsung Corporation to develop electronic marketplaces. It won an e-marketplace implementation project from UniBid, a B2B e-business initiative in the medical industry. Around the same time, it also secured six systems-integration projects, valued at a total of KRW500 million, with clients including MetLife, LG-Caltex, and Hyundai Motor Company. Most of these projects were won through the firm’s strong connections with IBM—a partnership that NeoGenius had tightened during the previous year. In June 2001, NeoGenius was selected as one of three B2B solution providers in the IBM Korean e-commerce solution offering service (KeCOS). For each KeCOS project, NeoGenius would earn KRW80–100 million for the software package plus customization fees.

NEOGENIUS IN JUNE 2001

All the operational data indicated that NeoGenius was up and running, but the business was not growing as fast as the cofounders had hoped. Financial performance from January 2000 to June 2001 was far short of the projection in the original business plan (see Exhibit 2). By June 2001, cash flow was also a concern. At the current rate, most of the seed funding would be exhausted by the end of the year. Some of the cofounders began to question the company’s optimistic outlook and ability to execute its business strategy, with one cofounder stating,

As you know, B2B e-business can be classified as a “solution of scale.” The question is whether this market is really accessible for the small companies like us. It is always the case that we are so close to, but only close to, winning contracts. For instance, LG Electronics selected a package from a global vendor over NeoSite for B2B. They do not see us as a “proven” solution provider.

Other cofounders worried that NeoGenius had strayed from its original goals by adopting opportunity-driven, emergent strategies. Systems-integration projects generated cash flow but had low profit margins, typically around 20 per cent. Moreover, these projects did not exactly help the company’s B2B business, as one cofounder explained:

Since we could not generate significant sales from our B2B solution business as of yet, we had no option but to pursue alternative opportunities available. And they were always systems-integration projects won through connections with IBM Korea. I do hope that know-how from these projects will be helpful in the long term. But we should not forget that we founded NeoGenius to escape from the life of systems-integration projects. Up to now, our systems-integration clients have not been exactly our ultimate target clients in the B2B market. Further, core programmers were frequently dispatched to systems-integration projects, which significantly delayed the development of NeoSite for B2B.

NeoGenius’s key employees blamed the depressed market for their slow progress. At the same time, they acknowledged that a new leader had emerged in the B2B e-business solutions market: ICOMPIA was now the prominent player in the market. It was founded by industry procurement specialists from Samsung Electronics and Daewoo Motors, and had won various e-procurement projects from clients such as Korea Telecom, FaCos (a textile e-marketplace), and Hyundai.

Hyundai represented a particularly bitter defeat for NeoGenius. NeoGenius’s consultancy partner, i-MRO, was a major advisor on a large Hyundai project, and NeoGenius had preferential access to the consulting outcomes. NeoGenius had also partnered with webMethods (an enterprise application integration software provider) to help Hyundai migrate from a host-based to a web-based procurement system; but after an exhaustive bidding process, Hyundai selected ICOMPIA as its solution provider. ICOMPIA was believed to be operating at a significant loss, but its expertise in the procurement process gave it a competitive edge.

THREE OFFERS

In the meantime, NeoGenius received three interesting and significant offers. The first was from a competitor, IB-Net. Kim noted that he was not surprised by the approach:

Since the November 2000 launch ceremony, NeoSite for B2B has quickly drawn attention from other B2B solution companies, and IB-Net was one of them. IB-Net has a well-recognized brand based on its success in the B2C area. But as we expected, IB-Net did not have its own B2B solution nor did it have expertise to develop one in-house.

Without its own B2B solution, IB-Net was experiencing some market difficulties. In March 2001, IB-Net approached NeoGenius with an offer to buy its solution through an exclusive original equipment manufacturer agreement. NeoGenius’s chief operating officer, Daniel Choi, summarized the deal: “If we accept the offer, we will be providing the NeoSite for B2B software package and related technical support solely to IB-Net. In return, NeoGenius would receive a royalty of KRW50 million for the software package plus a licence fee, depending on the size of the project. I think this exclusive deal will relieve us of marketing and sales burdens.”

However, Harrison Park, NeoGenius’s chief technology officer, was concerned:

The deal has certain merits, but the underlying implication is that NeoGenius should find a new opportunity other than B2B. It is an exit from the B2B market, but not a clean exit. We will be responsible for technical supports and upgrades of NeoSite for B2B, and for how long? We should be prepared to spare several skilled programmers for this task, and that is about everything for us.

The second offer came from i-MRO, NeoGenius’s consultancy partner. In April 2001, i-MRO management asked Kim whether NeoGenius would be interested in merger talks. i-MRO was believed to be in a great position, having secured venture capital investments and high-profile consulting projects, such as Hyundai and the Hansol Group (a paper conglomerate). Kim summarized the opportunity:

I-MRO management expects a synergy between i-MRO’s consulting expertise and NeoGenius’s tech expertise, which would make one-stop B2B service possible—and I totally agree with them. From our viewpoint, the merger would complement several of our critical weaknesses: knowledge of the procurement processes in various industries and general management skills. I think, together, we can win the B2B market.

On the other hand, the three younger partners were doubtful. Edward Wie, team leader of development, advised caution:

We will have to talk through this, but is it really a merger between equals? I mean, i-MRO is much better funded than us, and they are much more business oriented. I see this as an acquisition. We will become a solution department of i-MRO, and it will mean the termination of our entrepreneurial journey. That’s fine. But is that why we left our jobs?

Park had similar concerns:

I agree that it could be a winning combination, but I am concerned that the two companies have very different cultures. Basically, we are technology people working from this humble office full of computers and servers, and they are consultancy people working from fancy office cubicles. I am not sure if the merger will work out smoothly.

Kim and his cofounders believed that i-MRO was serious, but i-MRO would not reveal the details of its offer until NeoGenius had signalled its intention.

The third offer was from Sodano Capital, a Boston-based venture capital firm. In May 2001, Sodano Capital proposed a KRW3 billion investment through Meritz Securities, NeoGenius’s corporate finance advisor. This proposal was the first—and much awaited—outcome of NeoGenius’s second-round fundraising efforts. Kim saw a good deal:

Sodano Capital requested 15 per cent of NeoGenius equity (common stock) in return for its cash investment, which values our company at KRW17 billion. This is a fairly good valuation in the current market, considering that average investors are not willing to pay more than five times multiples.

Yet Choi was less optimistic:

The valuation is one thing. What I am worried about, though, is whether we can pass the extensive due diligence. We are struggling with our product development, and we are still figuring out the sales/marketing part of our B2B business. I mean, they approached us based on our business plan prepared last year. Have we been delivering the results?

NeoGenius management was concerned about the underlying condition that Meritz Securities would claim 10 per cent commission on the deal. There were no other conditions, but that was a double-edged sword. The deal would not undermine NeoGenius’s managerial control and freedom, but neither would it bring in anything other than cash. What NeoGenius really needed was managerial expertise and advice.

TIME TO DECIDE

The offers from IB-Net and Sodano Capital were valid only until the end of June 2001. There was no deadline on the i-MRO acquisition offer, but i-MRO management wanted to sign a memorandum of understanding by early July to show some progress to the company’s board.

Kim puzzled over what to do next. He knew that he did not have much time to lose. A sense of urgency was looming, especially since Choi had resigned in mid-June after a serious conflict with Park over the company’s business strategies.

Exhibit 1: NeoSite for B2B Market Positioning

NeoSite for B2B Target Markets

MRO

Capital

Equipment

Logistics

Management

Media

Textile

Chemistry

Auto

Elect

Steel

**NeoSite**

**Target Market**

NeoSite for B2B Strategic Positioning

Global high-end vendors  
(Ariba, etc.)

High-end

Low-end

High-end

NeoSite for B2B

Domestic B2B-specialized vendors

Global back-end-based vendors  
(SAP, Oracle, etc.)

**Performance**

Global mid-range vendors

Domestic B2C-based vendors

**Pricing**

Note: The company’s analysis is based on research from Gartner Group.

Source: Company files.

Exhibit 2: NeoGenius—Profit AND Loss Account (in KRW thousands)

|  |  |  |  |
| --- | --- | --- | --- |
|  | Profit and Loss Account | | |
|  | **2000** | **2001.6** |
| **Turnover** | 69,800 | 249,087 |
| Cost of sales | – | – |
| **Gross profit** | 69,800 | 249,087 |
| Administrative expenses | 215,890 | 431,817 |
| **Net operating income** | −146,090 | −182,730 |
| Non-operating items | −2 | 264 |
| **Profit before interest and tax (PBIT)** | −146,092 | −182,466 |
| Net interest receivable | 6,798 | 2,541 |
| **Profit before tax (PBT)** | −139,294 | −179,925 |
| Tax on profit on ordinary activities | – | – |
| **Profit for the financial year** | −139,294 | −179,925 |

Notes: The amortization of intangible assets was not considered in the profit and loss calculations. The combined profit and loss of NeoGenius and NeoMobile for the first half of 2001 ended on June 30, 2001.

Source: Company files.

1. KRW = South Korean won; currency amounts provided in US$ throughout the case assume the exchange rate of US$1 = KRW1,000. [↑](#footnote-ref-1)
2. Korean Securities Dealers Automated Quotations. KOSDAQ was established in 1996 as an electronic stock market, just like NASDAQ. [↑](#footnote-ref-2)